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Promotion and protection of all human rights, civil, political, economic, social and cultural rights, including the right to development

Written statement* submitted by Human Rights Advocates Inc., a non-governmental organization in special consultative status

The Secretary-General has received the following written statement, which is hereby circulated in accordance with Economic and Social Council resolution 1996/31.

[2 February 2018]

* This written statement is issued, unedited, in the language(s) received from the submitting non-governmental organization(s).

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How Foreign Debt Impact the Enjoyment of Human Rights: Contributions of Vulture Funds to the Privatization of Traditional Government Functions

I. Introduction

The greatest obstacle to the enjoyment of human rights, in relation to foreign debt, arises when debtor nations reach the point of economic insolvency where they must choose between providing public services or servicing debt obligations. In reality, the choice is never absolute, yet, the activities of private equity firms that specialize in purchase of distressed assets, cause disruptions to developing nations. There should be investigation into the human rights outcomes following the privatization of public services following catastrophic events of a financial, economic and force majeure nature.

In 2017 the Human Rights Council resolved to continue its investigation on foreign debt effects on the enjoyment of human rights.1 In its Resolution 34/3 it initiated the mandate for an Independent Expert's report detailing the exploitative nature of a species of private equity firms termed 'vulture' funds. 2 This report expands on the findings of the Independent Expert, which concluded that vulture funds flourish in this context due to the lack of authority in the establishment of solid sovereign debt restructuring mechanisms. This report suggests that the disruptive model of the vulture funds, left unregulated, will exacerbate foreign debt to the point where privatization of traditional government functions will be a threat to human rights.3

II. Foreign Direct Investment, Bilateral Investment Treaties, and Vulture Funds

The International Center for Settlement of Investment Disputes (ICSID) provides no guidance on how core human rights treaties, such as the International Covenant on Economic, Social, and Cultural Rights (ICESCR), may be considered during contractual disputes. The lack of integration between investment arbitration and international human rights becomes a matter of concern when private equity firms, commonly known as vulture funds, descend on struggling debtor countries. When holdout creditors, who refuse to restructure debt, sell their assets to vulture funds, negotiations for sovereign debt restructuring generally cease, and vulture fund creditors initiate aggressive litigation for full, or unsustainable, return on their investment.

The success of the vulture fund model results from the structure of the investment arbitration tribunal. Investment arbitration tribunals, courts created on an ad hoc basis that loosely follow ICSID Conventions, are the primary legal method for resolving trade disputes among countries. In 1965, with the establishment of ICSID by the World Bank, foreign lending, now known as Foreign Direct Investment (FDI), reemerged. Bilateral investment treaties (BITs) are the primary instrument for protecting foreign investments today. The modern international investment regime consists of nearly 3,000 bilateral investment treaties and over 350 multilateral treaties.4

Generally, FDI occurs because capital markets need to invest diversely, with a portion of capital dedicated to high-risk, high-return investments, which can take the form of lending to economically unstable or higher risk countries. As stated in Article 25 of the ICSID, FDI are transactions characterized by long-term, investments with a development component, between two sovereign entities. BITs are designed to settle FDI disputes, among other things. Application

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1 United Nations, General Assembly, *Mandate of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights*, A/RES/34/3 (23 March 2017).

2 United Nations, General Assembly, *Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and culture rights*, A/72/153 (17 July 2017).

3 Kate Arnoff, *Puerto Rico Governor Seizes Opportunity Created by Hurricane Maria, Plans to Privatize Electric Power*, THE INTERCEPT, (24 January 2018).

4 United Nations, Conference on Trade and Development (UNCTAD), *International Investment Agreements Navigator*, available from http://investmentpolicyhub.unctad.org/IIA.

of ICSID Article 25, however, has deteriorated over the years, and BITs are now hearing disputes that are of a purely financial nature.5

When a debtor State is unable or unwilling to pay its obligation, traditional creditors (valuing stability and development) often negotiate a restructuring of its debt. If, however, the bilateral agreement contains collective action clause, holdout creditors can significantly slow restructuring negotiations. Generally, delays in renegotiating lead to continued deterioration of the bond's value, forcing creditors to liquidate their assets on the secondary bond market at a substantial discount. Vulture funds purchase the heavily marked-down sovereign debt and instigate legal action for the sole aim of wining judgment for the full or substantial value of the bond(s).

III. The Case of Argentina

Argentina provides an example of how vulture funds prevent the restructuring of foreign debt. In 2001, Argentina experienced a profound financial crisis and defaulted on a $132 billion loan.6 In 2005, Argentina began its process of debt restructuring which called for the payment on seventy-six per cent of United States of America held bonds, amounting to an $82 billion repayment. In 2010, a second phase of negotiation resulted in ninety-three per cent of Argentina's bondholders accepting thirty per cent repayment for their bond. The remaining seven per cent of creditors, however, were owned by vulture funds and responded to these negotiations by filing suit against the country. The final judgment, heard in the Southern District of New York, found for the vultures who won the full payment of their bonds and an injunction prohibiting the repayment of the ninety-three per cent majority until these funds were paid in full. 7

According to Joseph Stiglitz, American economist and professor at Columbia University, the 2012 judgment did something pivotal to strengthen vulture funds. "The judge gave the vultures the weapon they needed: Argentina had to either pay them off or renege on the default they had negotiated, ruining the country's credit in the future and threatening its recovery."8

Vulture funds are a significant obstacle to debt restructuring, warranting the Human Rights Council's attention, as they threaten the financial solvency of developing nations. Argentina's inability to restructure its debt resulted in widespread defaulting on payments by energy companies, with an end result of power outages and unkempt electric grids, as well as other compromises of its' infrastructure.9

IV. How Vulture Funds Promote Privatizing of Recovery after Natural Disasters

In anticipation of inevitable natural disasters, insurance companies have created high-yield debt instruments which raise money for policy holders after an adverse financial, economic or catastrophic event, such as an earthquake, cyclone, or flood. Essentially, catastrophe bonds, or CAT bonds, allow investors to bet on whether insurance companies will face claims triggered by large-scale disaster.10 Typical catastrophic insurance policies use a payout method, known as the parametric insurance model that bases the insurance payout on the intensity of an event (e.g., seismic measurement for earthquake and windspeed for hurricanes) and the amount of loss is calculated in a pre-agreed model. An advantage of the parametric insurance model is that payouts can be made quickly and in-full.

It has been reported that, in the aftermath of Hurricane Maria, Puerto Rico's fast injection of cash to rebuild its electric grid resulted in political jockeying to privatize the country's Electric Power Authority.11 It is reported that the

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5 Supra n.2, 12.

6 Joseph E. Stiglitz, *How Hedge Funds Held Argentina for Ransom*, THE NEW YORK TIMES, (1 April 2016).

7 NML Capital, Ltd. v Republic of Argentina, 144 F. Supp. 3d 513 (S.D.N.Y. 2015).

8 Supra n.6.

9 Ashley C. Brown, *International Experience with Private Sector Participation and Open Access in Power Grids*, Harvard Electricity Policy Group, Kennedy School of Government, p. 30-1, found at https://sites.hks.harvard.edu/hepg/Papers/2015/A%20Brown%20and%20R%20Salter%20-%20WB%202013.pdf; Colin Docherty, *Argentina's Energy Industry: From Menem's Privatization to Kirchner's Revolution (and Power Outages)*, THE BUBBLE, (10 February 2014), found at http://www.thebubble.com/explaining-argentinas-energy-industry-menems-privatization-kirchners-revolution-and-your-power-outages/.

10 Gillian Tett, *Why Buffett is steering clear of catastrophe bonds*, FINANCIAL TIMES, (8 May 2014), found at https://www.ft.com/content/5c5dd0d6-d697-11e3-907c-00144feabdc0

11 Id. n. 3.

State is currently arranging the sale of its utility system to various bidders. The Intercept's report suggests that outside construction contractors, themselves accountable to shareholders, make privatizing the country's electric utility unlikely to yield long-term efficiency and reliability to Puerto Rico.12

Vulture funds, by their nature, deplete the power of the state to maintain its financial health. The State's deteriorating credit and inability to restructure debt, in turn, promotes opportunistic restructuring or privatization of national assets. Looking at the effects that catastrophic events have on the sale of State assets lends further insights as to how foreign debt impacts the enjoyment of human rights as state critical infrastructure is now owned and governed by a profit motive instead of. the more "public benefit" motivations of the State.

V. Recommendations

Human Rights Advocates (HRA), urges the Human Rights Council to expand its mandate on the effects of foreign debt on the enjoyment of human rights to include study of the long-term effects of privatization of traditional government functions. As part of this, HRA requests the Independent Expert should extend its' study on vulture funds to see how they correlate to the privatization of utility and other infrastructure systems in developing nations, and the outcomes as they relate to the enjoyment of human rights, specifically economic, social and cultural rights.

12 Id. n. 3.